

1962

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John W. Queenan

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## Recommended Citation

Haskins & Sells Selected Papers, 1962, p. 022-030

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# The Natural Affinity of Law and Accounting

by JOHN W. QUEENAN  
Partner, Executive Office

*Presented before Joint Meeting of the Oregon Society  
of Certified Public Accountants and the Multnomah  
County Bar Association, Portland, Oregon—April 1962*

COÖPERATION, TEAMWORK, AND NEGOTIATION are the methods by which our society has been able to achieve rapid scientific, social, political, and economic advancement. The professions of law and accounting are demonstrating that they, too, have adopted such measures in order to render improved services to their clients and to the public in general.

I have had an unusual opportunity to study the relations between our two professions. As co-chairman of the National Conference of Lawyers and Certified Public Accountants I have had the privilege of working closely with distinguished members of the American Bar, such as Judge William J. Jameson, a past president of the American Bar Association, and Dean Erwin N. Griswold of the Harvard Law School, both of whom have served as my fellow conference co-chairmen. We have had many long talks about how lawyers and CPAs can work together for the great advantage of their common clients. I am convinced that no two professions have a greater natural affinity than these two. I also am convinced that no professions have a greater opportunity for growth and useful service in the expanding U. S. economy, and I believe that their growth and opportunities will be the greater if they work closely together than if they do not.

Accounting is essentially the measurement and communication of financial and other economic data. But the financial and economic data that have to be measured and communicated are largely determined by legal processes. They include titles to property, contracts, and rights and obligations of all sorts that are determined by the law.

CPAs accept these legal determinations. This is where they start. If there is any question about the validity of a legal instrument, or a legal structure, the CPA will not attempt to resolve it. He will require an opinion of competent legal counsel on the basic questions before attempting to determine how the economic right or obligation should be treated from the accounting point of view. Consequently, CPAs are constantly raising questions with their clients that require consultation with, and advice of, lawyers.

Conversely, lawyers, in drafting legal documents of all kinds, have to deal with questions involving the measurement and communication of financial and economic data. More and more we find members of the Bar seeking consultation with, and the advice of, CPAs on questions of accounting and accounting terminology that arise in the legal aspects of business activities.

As business has become more and more complex, accounting, in its effort to measure and communicate financial and economic aspects of business, naturally has become more complex also. Today, the problems confronting CPAs require the exercise of highly sophisticated judgment, often involving the necessity of making difficult choices between alternative positions. Essentially, the CPA's job is to reduce to understandable terms, in reasonably concise form, all the financial aspects of a business. At the risk of oversimplification, it may be said that basically the CPA is concerned with distinctions between capital and income, which are often exceedingly difficult; appropriate classifications of income and expense, which again often present baffling difficulty; the appropriate matching of costs and revenues, which requires skilled estimates and experienced judgment; and allocations of transactions to proper fiscal periods.

Some indication of the magnitude of the CPA's task today may be afforded by the fact that the American Institute of Certified Public Accountants is spending about \$200,000 a year for research aimed at the further development, refinement, and exposition of accounting principles governing the treatment of various types of financial and economic data in corporate financial statements. Some of the topics now under study are: long-term leases, business combinations, deferred income taxes, price-level changes, pension costs, intercompany investments, and foreign operations.

## THE ECONOMIC OUTLOOK

The mere mention of these subjects suggests the impact that changing social, economic, and political circumstances are having on accounting. I suspect they have an equally powerful impact on the law.

The professional practices of each group are bound to be affected by the environment. Never before in history has the environment been changing as rapidly as in our times. Let me mention just a few of the probable developments in the years ahead that will significantly affect our professional activities.

1. Technological advances and automation result in increasing capital investment for each worker employed. The need for larger pools of capital requires accumulation of the savings of the people, and encourages increasing diffusion of the ownership of corporations. The need for larger accumulations of capital results in larger industrial units, both through growth and through merger. The separation of ownership and management of the larger corporations tends to increase the demand for greater accountability on the part of the management, and ever more rigorous standards of conduct.

2. Unless the balance of payments deficit should result in restrictions, foreign investment and trade seem destined to expand steadily. In both public and private channels, United States capital will undoubtedly continue to move into both the industrialized and developing nations. American businessmen interested in operations abroad will need professional advice on foreign laws, taxes, and auditing and financial reporting standards.

3. The trend toward bigness in industrial corporations does not appear to be stifling the growth of small business. In fact, small business is also getting bigger. There are an estimated 4 million and several hundred thousand separate entities now conducting business in this country—some 95 per cent of which are small, as measured by the standards of the Small Business Administration. If these smaller units are to continue to compete with the big corporations, equipped as the latter are with the best technological and professional advice available, the small business will have to have adequate legal and accounting help.

4. There seems to be no reason to doubt that government participation in the economy will continue to increase rapidly, as it has done throughout the past thirty years. The government is now engaged, and it will probably engage even more extensively in the future, in a wide variety of activities relating to both legal and accounting problems; for example, regulation of rates of monopolies, reporting requirements prerequisite to the issuance of securities, and providing financial support through direct loans, equity investments, and insurance. The increasing tendency to utilize the Federal income tax as an incentive to encourage conduct considered socially or economically desirable, also introduces new complexities both legal and accounting in nature.

5. Economic planning on a national scale is not beyond the bounds of possibility. Interest in Washington is reported concerning

the planning mechanism France has adopted—a nation-wide economic plan developed through voluntary but organized effort in which business, labor, and government all participate. This planning appears to include projections of over-all demand, agreement on investment priorities, and allocation of resources designed to produce optimum economic growth.

Any such system undoubtedly would give rise to a host of new legal and accounting problems.

6. It is predicted that foreign competition, resulting from the successful development of the European Common Market and the probable entrance of Great Britain into that market, will force U. S. industries to study carefully means of competing with European industries. Undoubtedly, a reexamination of the subject of labor relations will be considered. The apparent assumption that periodic wage increases are normal and almost automatic may have to be reconsidered. Growing public impatience with strikes which disrupt the economy and inflict huge losses on both workers and stockholders may result in strong pressure for some means of settling union-management disputes on the basis of factual data permitting a rational determination of labor's fair share in the fruits of production. This in turn would give rise to new accounting and legal problems.

#### EXISTING AREAS OF COOPERATION

My prediction that these probable future developments will bring lawyers and CPAs into even closer collaboration is borne out by the trends of the recent past. In my own firm we find ourselves working with lawyers each day on an ever-widening variety of business matters.

In this connection, a very interesting passage appeared in an article entitled *Accountant As Problem-Discoverer*.<sup>1</sup> The author, Louis M. Brown, a lawyer, pointed out that while the lawyer traditionally works with unusual situations and is usually consulted only when legal problems have arisen, the accountant, on the other hand, examines his client's accounts periodically regardless of whether or not unusual problems have been noted. Mr. Brown suggested, therefore, that the accountant has an important rôle as a *problem-discoverer*. He can find situations that may present legal problems before irrevocable

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<sup>1</sup> 1958 University of Southern California, School of Law, Tenth Tax Institute, pp. 27-42.

decisions have been made by the client. Mr. Brown said: "The problem-discovery function of accountants is not limited to taxation. It includes discovery of possible trouble in the whole range of law."

In my own experience I have found this to be true. In the course of our audits we often find matters that raise questions in our mind, the answers to which often require consultation with legal counsel. Let me illustrate by reference to a few specifics.

When a company is *going public*, and registration with the SEC is required, the CPAs normally prepare the financial section of the registration statement, while lawyers will normally draft or review what is commonly known as the narrative section. The CPAs, however, will often find transactions reflected in the books that may have a bearing on what is stated in the narrative section. Accordingly, it is customary for the CPAs to review the narrative section as a cross-check and for the lawyers to review the financial section, in order to avoid possible inconsistency.

In the field of estate planning, the CPA is often in the best position to discover the need of a client for better arrangement of his affairs. Businesses conducted as proprietorships or closely held corporations often give rise to situations in which the untimely death of a key figure would be unfortunate for all concerned. Frequently, the client does not realize the risks to which he is exposed until someone brings them to his attention, and this is often his CPA. Naturally, no CPA would proceed with the development of an estate plan without the participation of a lawyer.

The same sort of thing occurs in connection with pension and profit-sharing plans. The CPA is frequently the only one with knowledge of a client's need for such a plan. But a lawyer is sure to be brought in if a plan is actually developed.

Many a small businessman would go into bankruptcy or liquidation without the close coöperation of his lawyer and CPA. These two may set up a voluntary plan of extension of debts, arrange for an issue of debentures for the major creditors, and develop budgets, cash projections, and other financial data necessary for the continuity of the business. Again, it may be the CPA who discovered the problem before it became too acute.

Claims for insurance losses are often difficult to settle. Sometimes it is necessary to prepare for litigation. In such cases CPAs have compiled facts on industry trends, profit margins, continuing expenses, sales and purchase contracts, and similar matters, while the

lawyer has reviewed the law and prepared the pleadings. As a result they often have brought the case to a satisfactory settlement without going to trial.

In labor negotiations members of the two professions also work together. CPAs may establish the facts on unit costs, productivity of the workmen, overheads and similar items, while lawyers conduct or assist in the conduct of negotiations.

To these illustrations of areas for collaborative effort might be added corporate reorganizations, mergers, spin-offs and liquidations, preparation for various types of litigation, expert testimony, preparation of contracts employing accounting concepts, and others.

#### INCOME TAXES

The field in which lawyers and CPAs work together probably more extensively than in any other is the field of Federal income taxation. This is the area where collaboration can be vitally important, but, oddly enough, it is also the area where differences of opinion between the two professions have occurred.

Perhaps an occasional misunderstanding was natural, because individual lawyers and individual CPAs are likely to approach the question from completely opposite viewpoints. The lawyer subconsciously thinks that the tax law is a law, that the interpretation of a law is the practice of law, and, therefore, that nobody but lawyers ought to have anything to do with it.

A CPA subconsciously thinks the determination of income relates to the measurement and communication of financial data. The fact that there are special rules for determining income under the tax law doesn't change the nature of the process from his point of view. There also are special rules that must be observed in filing financial statements with the SEC, or with the regulatory commissions. Determination of income, the CPA feels, remains an accounting problem.

The fact is, of course, that law and accounting are both present in the field of income taxation, and they sometimes get so intermingled that nobody can draw a clean line down the middle and thus separate them.

Some misconceptions have occurred among the members of our two professions about each other's operating habits and procedures. Sometimes it has not been the substance of things done so much as the manner of the doing that has led to false impressions among our

two groups about motives and purposes. Sometimes these misunderstandings have been fanned by critical attitudes.

Whatever these difficulties may be, it would be entirely erroneous for anyone to get the impression that we are at war with each other.

In an attempt to substitute an approach based on mutual respect and good faith, in lieu of what might be termed an *unauthorized practice approach* to these difficulties, a program of coöperation and collaboration was put into practical operation five years ago with the reconstitution of the National Conference of Lawyers and Certified Public Accountants. The program was based on the Statement of Principles promulgated by the National Conference and adopted by the national organizations of both professions in 1951.<sup>2</sup> This statement is primarily a guide to coöperation, not a definition of the practice of law or of the practice of accounting.

The machinery set up to activate the Statement of Principles was essentially very simple; it consisted of the reconstituted National Conference of Lawyers and CPAs (a conference of six members: 3 lawyers and 3 CPAs) whose primary function is to settle questions that may arise between the two professional groups when working on tax or other problems and to investigate complaints against members of either profession. Several individual states also have established coöperating committees for the same purpose based on the national Statement of Principles or similar statements closely resembling the national statement.

The record of collaboration and coöperation, under the leadership of the National Conference, has clearly proved its value not only to the professions of law and accounting, but also to our respective clients. A policy of coöperation places the interest of the client in the forefront. We believe it is vital to the future of business that such coöperation make litigation or legislation unnecessary.

I can assure you that CPAs, who know their limitations, do not want to get into legal matters. Similarly, I think most lawyers do not want to get into accounting matters. I believe that most tax lawyers would agree that in the absence of any unusual question of a legal nature, the preparation of a business income tax return is basically an accounting job. At the other extreme, everyone would agree that representation of a taxpayer in court is exclusively a legal job. In

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<sup>2</sup> Statement of Principles Relating to Practice In The Field of Federal Income Taxation, *American Bar Association Journal*, v. 37 July 1951, p. 517-536; *Journal of Accountancy*, v. 91, June 1951, p. 869-71; *Unauthorized Practice News*, v. 17, July 1951, p. 17-20.



between, there are various stages of procedure and various types of subject matter which may indicate a particular problem could better be handled by a lawyer alone, or by a CPA alone, or by the two working together. After years of study of this question I am convinced that nobody can draw a clear and workable set of rules defining what the lawyer can do or what the CPA can do in the field of income taxation. Rather, I think, we should work together to educate our members to the fact that it is in their own self-interest to be conscious of their limitations and to seek the coöperation of a member of the other profession when there is any doubt in the mind of anyone about whether or not a given question properly falls within his own field.

In the long run, helpful professional service and advice gives rise to demand for more service and advice. We are fortunate that in the expanding American economy there is not only plenty of opportunity for service, but also adequate reward for anyone who has something useful to offer. Certainly there is more accounting work to be done than there are qualified CPAs to do it. I suspect that there is more legal work to be done than there are lawyers to do it.

Our objective should be to inform businessmen how these two professions can help them to do a better job. And of overriding importance is the strong probability that the lawyer and the CPA who work together, when circumstances dictate, will turn out a better job for the client.

## CONCLUSION

Our profession, and the other professions as well, also have common problems. We must be constantly examining the basic readjustments in relations between government and business and the professions themselves.

A related problem is what, for want of a better phrase, we call the public image. In this country professions have enjoyed public respect and confidence. But they may not always be so fortunate. We must constantly reexamine our own conceptions of our rights, privileges, and responsibilities. We must see that the standards we profess are actually observed. We must lose no opportunity to communicate with the public to improve its understanding of why we think our services are useful to society. Neglect of this area of public relations could be fatal.

We also have to protect the legitimate interests of our members. While we have sometimes suffered from its over-zealous advocates, we CPAs are sympathetic with the legal profession's determination to stamp out the unauthorized practice of law. It is not in the public interest to undermine professional standards by permitting unqualified and undisciplined persons to perform the same services as those for which the legitimate practitioner must be trained by lengthy educational process and be subjected to rigorous sanctions. We CPAs realize that few people outside of our profession know the difference between a CPA and any of the other varieties of accountants. We are judged not only by the actions of our fellow CPAs, but also by the actions of others who describe themselves as accountants. We have a major task in communications to accomplish, and we hope in time to have the law recognize that the part of our work most highly charged with public interest should be restricted to those who have satisfied our rising educational requirements, have passed our uniform CPA examination (the only uniform examination in any profession in this country), and have submitted themselves to our code of ethics.

The economic problems of the professions need attention. Professional men suffer a grave disability under present tax laws in attempting to provide retirement income for themselves. The American Bar Association and the American Institute of Certified Public Accountants have worked shoulder to shoulder in an effort to have this inequity rectified by amendment of the Revenue Code.

Intimations that activities of professional societies might be held subject to anti-trust deserve study and consideration.

There are a host of matters on which it would be advantageous for representatives of the professional organizations to confer. If they adopted uniform policies and joined together in expressing their approval of, or opposition to, proposals affecting them, the effectiveness of their positions would undoubtedly be increased.

All in all I am an ardent advocate of coöperation between the legal and accounting professions both at the level of practice by individual members and at the level of professional policy-making.